UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF WEST VIRGINIA
MARTINSBURG DIVISION

JOHN KNOTT

Plaintiff,

Case No.: 3:1-cv-82-JPB

v.

HSBC CARD SERVICES INC.

Defendant

DEFENDANT HSBC CARD SERVICES INC.'S REPLY IN SUPPORT OF ITS MOTION TO DISMISS

Plaintiff's Complaint should be dismissed because it improperly seeks damages, under only state law causes of action, for HSBC Card Services Inc.'s ("Card Services") alleged violation of the bankruptcy discharge injunction. Plaintiff's state law claims are preempted by the Federal Bankruptcy Code. But instead of bringing a motion for contempt under 11 U.S.C. § 524—the exclusive means for redressing a violation of the discharge injunction--Plaintiff asserts state law claims in an obvious attempt to plead around the Federal Bankruptcy Code. Such artful pleadings are impermissible. Additionally, Plaintiff's state law claims are also preempted because they affect bankruptcy rights and remedies by improperly creating a cause of action that does not exist under the Bankruptcy Code. Plaintiff should have brought his claim in the bankruptcy court as a motion for contempt, but he failed to do so. Since Plaintiff's claims are preempted by the Federal Bankruptcy Code, his Complaint should be dismissed.

I. ARGUMENT

A. Plaintiff's State Law Claims Are Preempted by the Federal Bankruptcy Code.

Because the Bankruptcy Code was created under the Article I, Section 8 of the United States Constitution, it is "the supreme Law of the Land, . . . Any Thing in the Constitution or

Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. Thus, when a state enacts a statute that affects a party's rights or duties in a bankruptcy proceeding, the Court must determine whether the state law is a bankruptcy law that is expressly preempted by the Federal Bankruptcy Code or whether the state statute is not a bankruptcy law, but has an impermissible application as it relates to the Federal Bankruptcy Code. *See, e.g., Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 526 (1933); *International Shoe v. Pinkus*, 278 U.S. 261, 265 (1929).

The Court analyzes four standards in determining whether a state law that is not a bankruptcy law is preempted by the Federal Bankruptcy Code: (1) whether the state law is expressly preempted; (2) whether Congress intended to occupy the entire field; (3) whether the state law conflicts with the federal statute such that the state law cannot be given effect; and (4) whether the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *Johnston v. Telecheck Servs., Inc.*, 362 B.R. 730, 735 (Bankr. N.D.W. Va. 2007) (citing *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 372-73 (2000) ("[T]he categories of preemption are not 'rigidly distinct' . . . [T]he entire scheme of the statute must of course be considered . . . ."); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) ("Our primary function is to determine whether, under the circumstances of this particular case, [a state's] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.")).

The state statute that Plaintiff alleges Card Services violated prohibits a debt collector from utilizing unfair or unconscionable means to collect a debt, and provides specific examples of conduct that is deemed to violate the section. W. VA. CODE § 46A-2-128. The statute provides, in part:

> No debt collector shall use unfair or unconscionable means to collect or attempt to collect any claim. Without limiting the general application of the foregoing, the following conduct is deemed to violate this section:
>
> * * *
>
> (e) Any communication with a consumer whenever it appears that the consumer is represented by an attorney and the attorney's name and address are known, or could be easily ascertained, unless the attorney fails to answer correspondence, return phone calls or discuss the obligation in question or unless the attorney consents to direct communication.

Id. This section does not seek to regulate bankruptcies; instead, it was created to give consumers a state law cause of action where one did not previously exist in the event a creditor utilizes unfair and unconscionable means to collect a debt. *State ex rel. McGraw v. Scott Runyan Pontiac-Buick, Inc.*, 461 S.E.2d 516, 523 (W. Va. 1995).

1. Plaintiff's State Law Claims Are Preempted Because Congress Provided the Exclusive Remedy for a Violation of the Discharge Injunction in 11 U.S.C. § 524.

"[S]everal courts have determined that state law causes of action that would allow a debtor to collect damages for a violation of the discharge injunction are foreclosed by the remedies provided by § 524 of the Bankruptcy Code." *Johnston*, 362 B.R. at 737 (listing cases).

Indeed, as this Court has previously explained, the remedy provided for by § 524 is the exclusive remedy for a violation of the discharge injunction. *Johnston*, 362 B.R. 737; *Cox v. Zale Del., Inc.*, 239 F.3d 910, 915 (7th Cir. 2001).

In *Frye v. Bank of America, N.A.*, No. 3:10-CV-47, 2010 WL 3244879 (N.D.W. Va. August 16, 2010), a debtor whose debt had been discharged in bankruptcy brought a four-count Complaint that alleged the creditor violated various state laws and § 524 for continuing to attempt to collect her discharged debt. The debtor alleged the creditor violated W. VA. CODE § 46A-2-128(e) and W. VA. CODE § 46A-2-128(d), which provides that the collection or attempted collection of unauthorized charges, fees, or expenses is an unfair or unconscionable debt collection practice. The Court held that the debtor's claims under W. VA. CODE § 46A-2-128(d) (which prohibits unfair or unconscionable debt collection practices like W. VA. CODE § 46A-2-128(e)) were preempted by the Federal Bankruptcy Code.[1] *Id.*, at *15. The Court was not persuaded by the debtor's argument that these claims were based upon violations of the contract, stating **"[n]o matter the form of WVCCPA violation alleged**, the dispositive factor is that the plaintiffs rely upon violations of the discharge injunction to support their claims . . . ." *Id.*, at *16. In dismissing the state law claims, the Court held: "As explained in *Johnston*, allowing such claims to proceed would directly contravene 'Congressional exclusivity in the field of bankruptcies.'" *Id.*

Congress provided the exclusive remedy for a violation of the discharge injunction, thus W. VA. CODE § 46A-2-128(e), which prohibits unfair and unconscionable debt collection, is preempted by the Federal Bankruptcy Code. The purpose of W. VA. CODE § 46A-2-128 is to prevent creditors from utilizing unfair or unconscionable means to collect a debt. W. VA. CODE § 46A-2-128. Even though the statute provides specific examples of unfair or unconscionable conduct in order to assist creditors with compliance, the purpose of the statute (and its individual subsections) is to protect consumers from harmful debt collection practices. *Id.* But with regard to a claim for a violation of the discharge injunction in bankruptcy, Congress intended to occupy the entire field through its enactment of 11 U.S.C. § 524. *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502, 510-11 (9th Cir. 2002) (stating that the Bankruptcy Code provides the sole remedy for a violation of the discharge injunction and "[t]o permit a simultaneous claim under the FDCPA would allow through the back door what [the creditor] cannot accomplish through the front door—a private right of action."); *Bassett v. Am. Gen. Fin., Inc. (In re Bassett)*, 255 B.R. 747, 754 (9th Cir. BAP 2000) (aff'd in part, rev'd in part on other grounds by *In re Bassett*, 285 F.3d 882).

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[1] This Court also held that the debtor's claims under W. VA. CODE § 46A-2-128(e) were preempted by the National Bank Act and a Code of Federal Regulation. *Id.*, at *13.

Plaintiff incorrectly argues that W. VA. CODE § 46A-2-128(e) is not preempted by federal bankruptcy law, relying on *Johnston v. Valley Credit Servs. (In re Johnston)*, 2007 Bankr. LEXIS 1174 (Bankr. N.D.W. Va. Apr. 12, 2007) for support. But the *One Valley* Court[2] held that it did not have jurisdiction to decide any of the issues presented to it, thus its statements on the issue merely constitute dicta and, moreover, the cases it relied upon are significantly distinguishable. *Id.*, at *2 ("For the reasons stated herein, the court finds that the Debtor's claim under W. Va. Code § 46A-2-128(e) is not preempted by the Bankruptcy Code, but that **the court is without subject matter jurisdiction to adjudicate the dispute.**") (emphasis added).

In deciding that W. VA. CODE § 46A-2-128(e) is not preempted by the Bankruptcy Code, the *One Valley* Court relied upon *Sears, Roebuck & Co. v. O'Brien*, 178 F.3d 962, 966-67 (8th Cir. 1999); *Sturm v. Providian Nat'l Bank*, 242 B.R. 599, 602 (S.D.W. Va. 1999); and *Alexander v. Unlimited Progress Corp.*, No. 02-C-2063, 2003 U.S. Dist. LEXIS 5560 (N.D. Ill. March 24, 2003). The rulings in these three cases are the minority rule. *See, e.g., Wehrheim v. Secrest, P.C.*, No. IP 00-1328-C-T/K, 2002 WL 31242783, at *6 (S.D. Ind. Aug 16, 2002) ("The courts are divided on this issue, but the majority have held that such FDCPA claims are precluded [by the Bankruptcy Code].")

Further, each of the three cases *One Valley* relied upon are distinguishable from this case. *Alexander* did not discuss state law preemption, but instead dealt with whether claims under the FDCPA were **precluded** by the Bankruptcy Code. *Alexander*, 2003 U.S. Dist. LEXIS 5560.

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[2] Card Services will refer to this case as *One Valley* to avoid confusion with *Johnston v. Telecheck Servs., Inc.*, 362 B.R. 760 (Bankr. N.D.W. Va. 2007).

Because one federal law cannot preempt another federal law, this preclusion issue was an entirely different analysis than state law preemption. *Id.* In both *Sturm* and *Sears, Roebuck & Co.*, the borrowers alleged violations of the automatic stay, not the discharge injunction. *Sturm*, 242 B.R. at 601; *Sears, Roebuck & Co.*, 178 F.3d at 966-67. Thus, the preemption analysis was different in those cases than in this case, where the discharge injunction and not the automatic stay is at issue.

Further, to the extent that *Sears, Roebuck & Co.* decided that the state law was not preempted by the Bankruptcy Code because Congress has not regulated the relationship between private lawyers and their clients, that reasoning is not applicable here. The state law at issue here—W. VA. CODE § 46A-2-128(e)—regulates debt collection, not the relationship between attorneys and their clients. The purpose of W. VA. CODE § 46A-2-128(e) is to give debtors a cause of action where one was difficult to maintain under the common law. *State ex rel. McGraw v. Scott Runyan Pontiac-Buick, Inc.*, 461 S.E.2d 516, 523 (W. Va. 1995). Allowing a debtor to maintain a state law cause of action under W. VA. CODE § 46A-2-128(e) due to an alleged violation of a discharge injunction would impermissibly permit the debtor to directly contravene "Congressional authority in the field of bankruptcies." *Frye*, 2010 WL 3244879, at *16. Indeed, Plaintiff even admits he could have asserted a claim for a violation of the discharge injunction, but instead purposely brought only state law claims. (Memorandum of Law in Support of Motion to Remand Case (*Docket No. 7-1*), p. 5, n.1.) Such end-runs around the Bankruptcy Code are not permitted. *Frye*, 2010 WL 3244879, at *16. Thus, W. VA. CODE § 46A-2-128(e) is preempted by the Federal Bankruptcy Code, and Plaintiff's Complaint alleging only claims under this state statute should be dismissed.

2. W. Va. Code § 46A-2-128(e) Is Preempted Because it Impermissibly Creates a Cause of Action That Does Not Exist Under Federal Law.

One of the four standards a Court analyzes in determining whether a non-bankruptcy state law is preempted by the Federal Bankruptcy Code is whether the state law attempts to affect the rights and remedies provided under federal law. *Johnston v. Telecheck Servs., Inc.*, 362 B.R. at 735; *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 372-73 (2000); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). In this case W. VA. CODE § 46A-2-128(e) impermissibly creates a remedy that does not exist under federal law. 11 U.S.C. § 524 does not provide a private cause of action for a violation of the discharge injunction. *Frye*, 2010 WL 3244879, at *20; *Johnston v. Telecheck Servs. (In re Johnston)*, 362 B.R. 730, 741 (Bankr. N.D.W. Va. 2007). Even though no private cause of action exists under federal law for a violation of the discharge injunction, Plaintiff has impermissibly asserted state law causes of action, seeking damages for an alleged violation of the discharge injunction. (Plaintiff's Complaint, ¶¶ 1-22.) By doing so, not only has Plaintiff pled around the Federal Bankruptcy Code, but he has attempted to create a cause of action where one does not exist. Indeed, Plaintiff **concedes** this was his intent. (Memorandum of Law in Support of Motion to Remand Case (*Docket No. 7-1*), p. 5, n.1.) Because Plaintiff's state law claims would affect the rights and remedies available under the Federal Bankruptcy Code by creating a cause of action that does not exist, Plaintiff's state law claims are preempted by the Federal Bankruptcy Code. *Johnston*, 362 B.R. at 735; *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 372-73 (2000); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).Thus, Plaintiff's Complaint should be dismissed.

B. The Proper Procedure For Asserting Allegations That a Creditor Violated the Discharge Injunction Is to Bring a Contempt Proceeding in the Bankruptcy Case.

Plaintiff's Complaint is nothing more than an improper, artful attempt to avoid Federal Bankruptcy Law in hopes of recovering additional damages that would not otherwise be available to him. *Federated Dept. Stores*, 452 U.S. at 408. As this very Court has held, the proper and exclusive procedure for asserting an alleged violation of the discharge injunction is to bring a contempt proceeding in the bankruptcy case. *Frye v. Bank of America, N.A.*, No. 3:10-cv-47, 2010 WL 3244879, at *15-16 (N.D.W. Va. Aug. 16, 2010) (citing *In re Johnston*, 362 B.R. 730, 741 (Bankr. N.D.W. Va. 2007); *Cox v. Zale Delaware, Inc.*, 239 F.3d 910, 917 (7th Cir. 2001)). Although Plaintiff seeks the imposition of statutory penalties under W. VA. CODE §§ 46A-5-101 and 46A-5-106, punitive sanctions are not available in a civil contempt proceeding. *Jones v. Lincoln Elec. Co.*, 188 F.3d 709, 738 (7th Cir. 1999) ("Civil contempt proceedings are coercive and remedial, but not punitive, in nature and sanctions for civil contempt are designed to compel the contemnor into compliance with an existing court order or to compensate the complainant for losses sustained as a result of the contumacy.") (citing *International Union, United Mine Workers of Am. v. Bagwell*, 512 U.S. 821, 826-28, (1994); *Connolly v. J.T. Ventures*, 851 F.2d 930, 932 (7th Cir. 1988)). Plaintiff's Complaint, which seeks damages for an alleged violation of the discharge injunction, is procedurally improper and should be dismissed.

II. CONCLUSION

Plaintiff's Complaint should be dismissed because it improperly asserts only state law causes of action for an alleged violation of the bankruptcy discharge injunction. These state law causes of action are preempted by 11 U.S.C. § 524 because Congress has sought to occupy the entire field with regard to recovery for an alleged violation of the discharge injunction. Permitting recovery under state law claims for an alleged violation of the discharge injunction would allow Plaintiffs impermissibly to plead around the Federal Bankruptcy Code. And since Plaintiff's state law claims attempt to create a cause of action for the alleged violation of the discharge injunction, W. VA. CODE § 46A-2-128(e) improperly attempts to affect bankruptcy related rights and remedies. Such an end-run around the Bankruptcy Code must not be condoned. Rather, the proper procedure for asserting an alleged violation of the discharge injunction is to file a motion for contempt in the bankruptcy case. Plaintiff's Complaint should be dismissed because his state law claims are preempted by the Federal Bankruptcy Code.

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CERTIFICATE OF SERVICE

I hereby certify that on this **2nd** day of **September, 2010**, a copy of the foregoing ***"Defendant HSBC Card Services Inc.'s Reply In Support Of Its Motion To Dismiss"*** was filed electronically. Notice of this filing will be sent to the following parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's system.

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